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TAX FOUNDATION'S **50th Anniversary Year** VOL. 31, NO. 7 NOVEMBER/DECEMBER 1987

TAX·FEATURES

Tax Foundation Marks 50th Anniversary; Honors Senator Moynihan for Public Service

Daniel Patrick Moynihan, senior United States Senator from New York State, will receive the Tax Foundation's Distinguished Public Service Award for 1987 at the Foundation's 50th Anniversary Dinner December 2. The Dinner concludes the Foundation's day-long conference on "Tax and Fiscal Policy — The New Agenda" at the Waldorf-Astoria hotel in New York City.

Hans W. Wanders, President of The Wachovia Corporation and Chairman of the Foundation's Board of Trustees, will present the award. A major policy address by Senator Moynihan will follow his acceptance.

Daniel Patrick Moynihan was elected to the United States Senate on November 2, 1976 and reelected in November 1982. The Senator serves on the Finance and the Environment and Public Works Committees and on the Select Committee on Intelligence; he is Chairman of the Subcommittee on Public Assistance of the Finance Committee.

Senator Moynihan has held Cabinet or Subcabinet posts under Presidents Kennedy, Johnson, Nixon, and Ford. He has served as United States Ambassador to India and as U.S. Permanent Representative to the United Nations. He has also held high administrative positions in New York State. His career in education includes posts at MIT and Harvard.

National Conference

The morning sessions of the all-day program will focus on the economic outlook and the Federal Budget and will include presentations by Edgar R. Fiedler of the Conference Board, White House Senior Policy Analyst Bruce Bartlett, Harvey Galper of Peat Marwick Main & Co. and Allen Schick of the University of Maryland.

Jeffrey H. Birnbaum, Congressional Reporter for The Wall Street Journal and Coauthor of *Showdown at Gucci Gulch*, will keynote the conference luncheon.

The afternoon session will address "Tax Policy Post Reform," with presentations by J. Roger Mentz of Cadwalader, Wickersham & Taft and former Assistant Secretary of the Treasury of Tax Policy, and David H. Brockway, Chief of Staff of the Joint Committee on Taxation.

Shadow Budget Committee Report Card Gives Congress and Administration Failing Marks for Fiscal Year 1987

By grading Congress and the Administration on five different aspects of budgetary performance, the Shadow Committee on the Federal Budget has handed down a report card that would make any self-respecting student cringe: A– for economic conditions (a judgment handed out prior to Wall Street's October 19 Black Monday); F for policy leadership; F for truth in budgeting; F for completion of required budget tasks; and for deficit reduction: a B for appearance, but a D for substance.

As bad as these grades are, they simply reflect the numerous budgetary failures and comparatively few successes that marked fiscal 1987.

The economy has not grown at the rate assumed in the budget, but it continues to demonstrate remarkable vigor, the report notes. The budget deficit was about $60 billion below the previous year's level, but much of the improvement was due to one-time factors that will not be available in future fiscal years. Congress changed the way the budget accounts for asset sales and other transactions that lower the deficit without producing real savings, but only after using billions of dollars of these tricks in the 1987 budget. Finally, Congress failed to enact a single regular appropriation bill by the start of the 1988 fiscal year, but its work was impeded by a recalcitrant President who refused to enter into negotiations with the Legislative Branch.

Even the one area of good performance is qualified by a "but". Good news about the deficit has been acccompanied by a sharp run-up in interest rates, possibly because investors fear that deficit reduction will be short-lived. If the big drop in 1987 proves to be just a blip in the upward trend of the deficit, the nation will pay a heavy price for the failure of the President and Congress to provide the leadership that would produce enduring deficit reduction.

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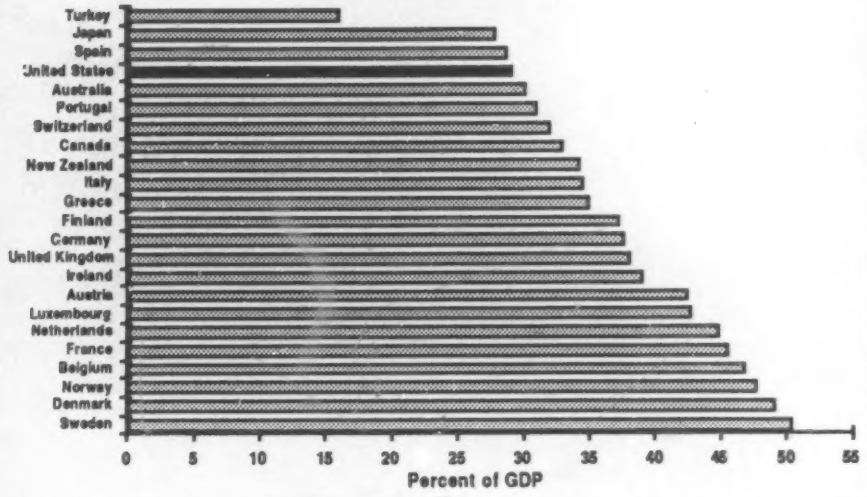
OECD Nations Show Great Diversity in Approach to Taxation



Despite numerous economic and political ties, member nations of the Organization for Economic Cooperation and Development (OECD) display great disparity in how they structure their respective tax systems.

In 1985 (latest reported), the share of revenue raised by individual and corporate income taxes ranged from less than 18 percent in France and Greece to 69 percent in New Zealand, 57 percent in Denmark, and 54 percent in Australia. Nations which collect either a very small part of their revenues from social security taxes or none at all tend to derive a large share of their revenues from taxes on income.

Income taxes furnish about 39 percent of tax revenue in the 23 OECD countries combined. The U.S. share — 43 percent — ranks ninth highest.

France and Greece raised the least through individual income taxes at 13 and 14 percent respectively. By contrast, New Zealand derived 60 percent of its tax collections from this source. Denmark also raised more than half of its revenues from individual income taxes. The United States, ranked seventh among the member countries, raised 36 percent of all revenues through the personal income tax.

Corporate profits tax levies also generate significant public revenue for most of the member countries.

(Continued on page 5)

Percentage Distribution of Tax Revenues in Selected Countries by Source
Fiscal Year 1985

	Taxes on Income and Profits[a]		Social Security Taxes[b]	Taxes on Goods and Services			Property Taxes[d]	Other and Unallocable[e]	Total Tax As % Of GDP	Per Capita Taxes[g]
					Consumption Taxes					
Country	Individ. Income	Corp. Profits		Total[c]	General	Specific				
Australia	45.1%	9.2%	-	32.5%	7.9%	20.3%	7.7%	5.5%	30.3%	$3,213
Austria	23.1	3.3	31.8%	32.6	21.0	10.4	2.4	6.8	42.5	3,714
Belgium	34.1	6.4	33.2	24.4	15.7	7.0	1.7	0.2	46.9	3,854
Canada	35.5	8.2	13.3	31.5	13.2	12.6	9.5	2.0	33.1	4,621
Denmark	50.2	4.8	3.8	34.2	20.0	12.9	4.3	2.7	49.2	5,573
Finland	46.6	4.0	9.0	36.7	21.2	15.1	3.0	0.7	37.3	4,116
France	12.7	4.3	43.6	29.4	19.9	8.7	4.6	5.4	45.8	4,218
Germany	28.7	6.1	36.5	25.6	15.8	8.7	3.0	0.1	37.8	3,869
Greece	14.0	2.7	34.9	43.3	17.2	21.5	2.7	2.4	35.1	1,178
Ireland	31.3	3.2	14.8	44.5	20.6	22.0	3.8	2.4	39.1	2,005
Italy	26.7	9.2	34.7	25.4	14.5	9.1	2.5	1.5	34.7	2,565
Japan	24.8	21.0	30.2	14.0	-	12.1	9.7	0.3	28.0	3,107
Luxembourg	26.3	18.2	25.5	23.9	12.8	10.5	5.6	0.5	42.8	4,748
Netherlands	19.5	7.0	43.9	25.8	16.3	7.3	3.5	0.3	45.0	3,879
New Zealand	60.0	8.4	-	23.2	10.4	11.7	7.1	1.3	34.3	2,304
Norway	22.5	17.0	20.6	37.5	18.2	18.2	1.7	0.7	47.8	6,668
Portugal	f	f	26.0	42.5	12.6	28.4	1.9	25.9[f]	31.1	676
Spain	22.6	5.5	41.5	26.4	14.1	12.4	2.8	1.2	28.8	1,226
Sweden	38.5	3.5	24.8	26.4	13.9	11.4	2.3	4.5	50.5	6,064
Switzerland	34.8	5.9	32.1	18.9	9.3	8.2	8.2	0.1	32.1	4,554
Turkey	33.7	11.8	5.1	44.0	28.5	15.1	5.6	-	16.1	170
United Kingdom	26.0	12.9	17.5	31.6	15.9	13.9	12.0	-	38.1	3,025
United States	35.7	7.1	29.4	17.7	7.4	7.9	10.1	-	29.2	4,740

[a] Includes taxes on capital gains.
[b] Includes taxes on self-employed.
[c] Includes import duties, profits on public fiscal monopolies, licenses, and other business taxes.
[d] Includes taxes on movable and immovable property, net wealth taxes, and estate and gift taxes.
[e] Includes general and selective taxes on payrolls which are not earmarked for social security purposes, and other taxes not elsewhere classified.
[f] Income and profit taxes are 25.9% of total taxes and are included under "other and unallocable", as they are not segregable between individuals and corporations.
[g] In U.S. dollars.
Source: Organization for Economic Cooperation and Development.

Tax Features

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Budget Watch

Federal Spending Jumps Trillion Dollar Hurdle

The Tax Foundation was established 50 years ago during the brief period between the Great Depression and World War II. The first of these crises led to the modern welfare state, the second to massive increases in defense spending. The growth of the Federal government has been a continuing story, however, which certainly did not end with these long-ago events. When the Foundation opened its doors, Federal spending was less than $10 billion a year; in the latest fiscal year, it exceeded a trillion dollars.

This article reviews the growth in expenditures during the past 50 years and discusses the implications for the Federal budget. The upward trend is summarized in Table 1 which displays total spending at 10-year intervals since 1938. The data show an incessant rise in Federal spending: in each of the selected years, spending has been higher than it was 10 years earlier. There have been few downturns in Federal spending, and all but one of these occurred after the cessation of war.

Inflation has accounted for a substantial portion of the spending increase, but the escalation is quite pronounced even when an adjustment is made for rising costs. Table 1 shows that in constant (inflation-adjusted) dollars outlays are 15 times higher than a half century ago. This trend has persisted in the 1980s despite widely-publicized claims of cutbacks in Federal spending. In constant dollars, fiscal 1987 spending exceeded the fiscal 1977 level by $200 billion. This is the largest real increase during any decade in American history.

There has also been a steep rise in relative spending, that is, in Federal outlays as a percentage of the gross national product (GNP). In the late 1930s, Federal outlays amounted to about 7 percent of GNP. The percentage had been much lower just a few years earlier, prior to the New Deal. Since then, relative spending has moved steadily upward; at almost 23 percent of GNP, it is now three times what it was a half a century ago.

The upward spiral in expenditures has been accompanied by a similar development on the revenue side of the budget. Revenues totaled 19 percent of GNP in the 1987 fiscal year, compared to only 6 percent 50 years earlier. But revenue growth has lagged somewhat behind that of expenditures and, as a result, budget deficits and the public debt have soared. In some recent years, the budget deficit has exceeded 5 percent of GNP, pushing total public debt to more than $2.5 trillion, and greatly increasing per capita debt (see chart below).

An understanding of the dynamic growth of Federal spending would be enhanced by reviewing developments in each of the past five decades.

1938–1947

By the late 1930s, the New Deal had turned emergency relief into permanent programs. The financial burden was modest at the outset — but the basis had been laid for a much larger Federal government in the future. Spending pressures during this decade were almost entirely war-related. Defense spending began to rise in the late 1930s and peaked in 1945 at almost 40 percent of GNP. Nondefense spending declined, both because economic recovery diminished the need for relief and because full mobilization dictated that resources not be diverted from the war effort. After the war, Federal outlays dropped sharply to only 12 percent of GNP in 1948.

1948–1957

This period left an enduring imprint on Federal expenditures. The protracted cold war meant that defense spending would be maintained at a high level even in peacetime. Although the United States was not at war in 1957, defense claimed almost 60 percent of total outlays. Except for the Interstate Highway Program, the Eisenhower Administration did not undertake major domestic expansions. But neither did it roll back the New Deal programs. The social innovations of the 1930s were accepted as a legiti-

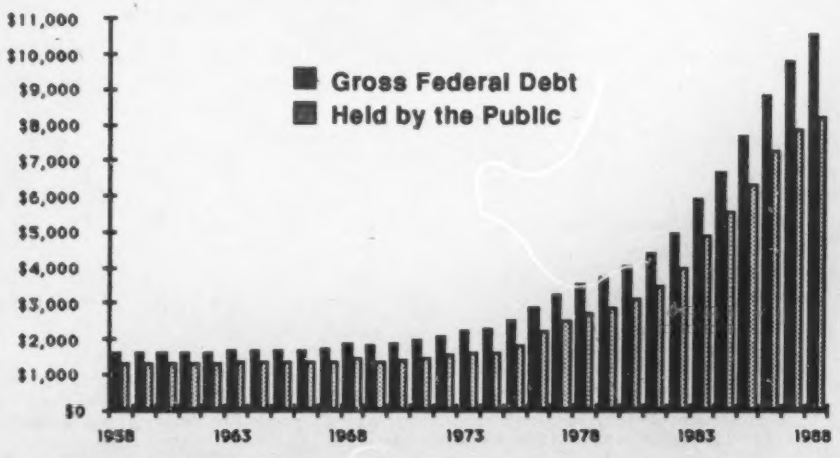
Table 1

Total Federal Outlays in Current and Constant (1982) Dollars and As a Percent of GNP, Selected Fiscal Years, 1938–1987

Fiscal Year	Total Outlays ($billions)	Outlays As % Of GNP	Outlays in Constant 1982 Dollars
1938	$ 6.8	7.7	$ 60.0
1947	34.5	15.4	212.8
1957	76.6	17.4	316.8
1967	157.5	19.8	488.7
1977	409.2	21.2	622.6
1987	1,016.9	23.0	862.9

Sources: The 1938 data are adapted from the Bureau of the Census, *Historical Statistics of the United States, Colonial Times to 1970*; the data for 1947–1977 are from the Office of Management and Budget, *Historical Tables*; and the 1987 estimates are from the Office of Management and Budget, *Mid-Session Review of the 1988 Budget*.

Per Capita Federal Debt at End of Year 1958—1988



mate, continuing responsibility of government in the 1950s.

1958-1967

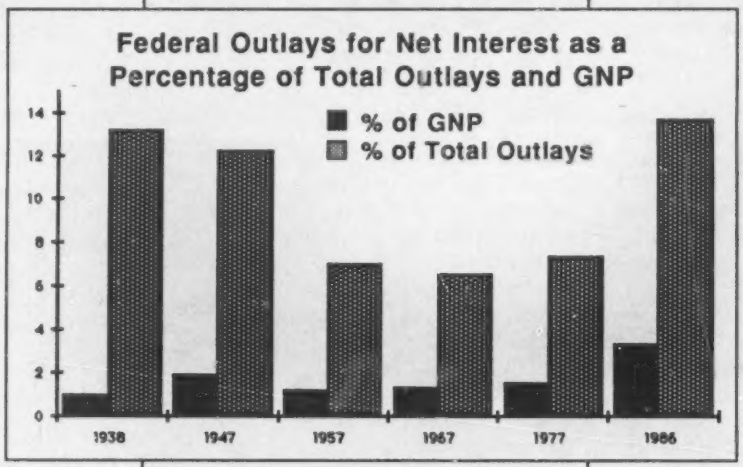
The Kennedy-Johnson years opened a new expansionary era in Federal budgeting. Expansion was spurred by the adoption of dynamic fiscal policies which called for tax cuts and spending increases to stimulate economic growth and by the enactment of ambitious Great Society legislation. These did not cost much at the start but some of them (especially Medicare and Medicaid) would become increasingly prominent in the future. During the first part of the 1960s, a vigorous economy made it possible for the government to expand without increasing its share of GNP. But escalation of the Vietnam War put pressure on the budget and produced a guns versus butter debate which has persisted for the past 20 years.

1968–1977

This period represented the end of the postwar boom during which economic growth had averaged more than 4 percent a year and the beginning of an austere period characterized by slower growth, higher unemployment, and bigger deficits. At first, various transfer programs, such as food stamps and social security, were enlarged, and a new sense of federalism led to the first revenue sharing program with the states and localities. Later, Congress established a new budget process in an effort to control Federal spending and deficits. Judging from the results, the new process has not been particularly successful.

1978-1987

The most recent decade has been dominated by the Reagan revolution, an attempt to rearrange budget priorities by building up defense forces, curtailing domestic spending, and reducing income tax rates. After startling success in his first year, the President has been locked in a protracted budgetary stalemate with Congress. Defense spending climbed rapidly in the early 1980s but has leveled off in recent years. Discretionary domestic programs have been cut back, but nowhere near the extent sought by the Administration, and transfers continue to claim a rising share of the budget. This has resulted in massive deficits and the enactment of the Gramm-Rudman-Hollings process which seeks a balanced Federal budget by the early 1990s.



The Changing Composition of Federal Spending

Over the years, the composition of expenditures has undergone considerable change. Table 2 traces five categories of expenditure: defense programs, payments for individuals, grants to state and local governments, interest charges, and other (mostly discretionary domestic) programs. The trend is unmistakably clear: payments for individuals have become the most prominent part of the budget. Fifty years ago, these payments were barely one billion dollars; today, they total almost $500 billion and account for almost half of total Federal spending. Most of these payments are in the form of entitlements, which obligate the government to provide financial assistance to persons who meet the eligibility requirements established in law.

In addition to these payments, the budget finances two other types of transfers: interest charges and grants to states and localities. Recent deficits have compelled the government to allocate a rising share of the budget to interest payments. As the chart above demonstrates, almost 14 percent of the budget goes to pay interest on the public debt, just about twice the percentage of a decade ago.

Grants have had a roller coaster ride in the Federal budget. During the

(Continued on page 6)

Table 2

Types of Federal Outlays in Current Dollars and As Percentages of Total Outlays, Selected Fiscal Years, 1938-1986

($billions)

Outlay	1938*		1947		1957		1967		1977		1986	
	$	%	$	%	$	%	$	%	$	%	$	%
Defense	1.0	14.7	12.8	37.1	45.4	59.3	71.4	45.3	97.2	23.8	273.4	27.6
Payments for individuals	1.1	16.2	9.1	26.4	17.0	22.2	43.2	27.4	196.3	48.0	448.0	45.3
State-Local Grants**	0.5	7.4	0.8	2.3	2.2	2.9	10.4	6.6	46.1	11.3	60.8	6.1
Net interest	0.9	13.2	4.2	12.2	5.4	7.0	10.3	6.5	29.9	7.3	136.0	13.7
All other	3.2	47.1	9.1	26.4	10.7	14.0	29.5	18.7	54.5	13.3	104.7	10.6
Offsetting Receipts	n.a.	n.a.	-1.5	-4.3	-4.1	-5.4	-7.3	-4.6	-14.9	-3.6	-33.0	-3.3

Sources: Same as Table 1.

*** Because of the different sources, 1938's figures are not strictly comparable to those for later years.**

**** Amounts shown for grants do not include grants which finance payments for individuals. Outlays for these grants are included in the payments for individuals category.**

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SPECIAL REPORT

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Lotteries: Entering the Big Time In State Finance

By John Hanly Adams
Editorial Consultant
Tax Foundation

Like it or not — and millions of Americans hate the idea on moral or other grounds — state owned and operated "numbers games" known better as lotteries are a growing part of the financial support for state and local governments in the U.S.

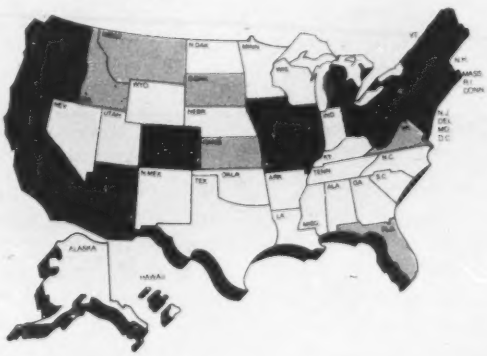
The latest available facts and figures on the increasing financial reach of government-sanctioned gambling are presented in this Tax Foundation Special Report. They show:

- A total of 22 states and the District of Columbia took in $12.5 billion in lottery sales, producing almost $5 billion in net lottery income, after expenses and prizes, in the fiscal year ended June 30, 1986. Net lottery income for all states has been growing at 29% per year since FY 1980, accelerating to 36% per year since FY 1984. Five additional states approved lotteries in fiscal year 1987. Virginia voters approved a lottery on November 3 and several other states are considering proposals. About three-fourths of the U.S. population now is exposed to state-operated games.
- Lotteries still are a small share of states' total income and charges — 1 to 5 percent of the revenue from state taxes and charges in FY '86 — and profits vary far more, and more unpredictably, than tax revenues. But lotteries' input, and thus their clout at state capitals, is growing. Lotteries brought in more revenue than tobacco and alcohol sales taxes last year in California, New York and eight other states and D.C.
- State lotteries also remain a small part of the gambling financial scene, in terms of dollars. Guesses about the total value of gaming and wagering vary wildly, especially as to the extent of illegal betting in its many forms. One educated guesstimate puts the total "handle" at $199 billion in 1986. In terms of people taking part — a crucial measure

Lotteries Spread, coast to coast —

In 1963 one state, New Hampshire, authorized the first modern state lottery.

Now, in 1987, 22 states and the District of Columbia operate lotteries and 6 others are starting them. Other states are debating the issue.



Lotteries' Rise in the gambling world —

State-owned and operated lotteries have become the fastest growing form of public betting in the U.S. Lottery ticket sales have quadrupled in the last five years, reaching $12.5 billion in the year ended June 30, 1986. But this apparently is only a fraction of the total gambling "handle" (the estimated aggregate sum of all money changing hands in public wagering). Casino table games and slot machines licensed by various states remain the King Kongs of gambling. See the chart on the next page for a perspective on that part of the story.

Map data from "1987 U.S. Gaming Industry" report by Laventhol & Horwath, CPAs.

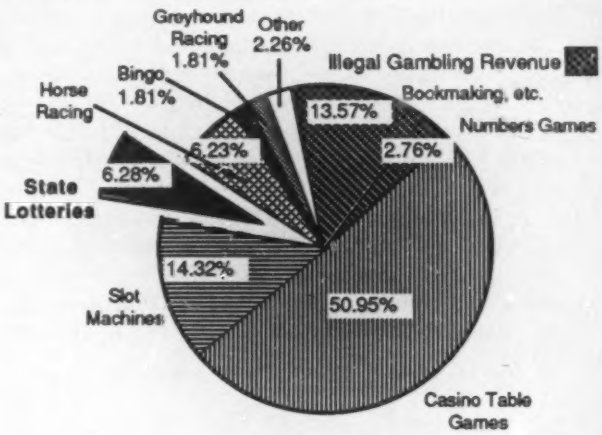
One Measure of the Gambling Industry

No recent official estimates of gambling finances in the U.S. have been published. A presidential commission on law enforcement estimated illegal gambling at $20 billion a year in 1967, and in 1974 the U.S. Department of Justice put the illegal total at $29 to $39 billion. An unofficial estimate of all gambling action is published annually by Gaming & Wagering Business, a monthly magazine. From its latest study, in the July 1987 issue, by Eugene Martin Christiansen, an economist and Special Assistant to the New York City Off-Track Betting Corp. —

"Aggregate gambling in American commercial games reached $199 billion in 1986; a $7.9 billion, 4.2 percent increase over 1985. The number is an all-time high. It is also partly illusory. More than half that $199 billion was the ebb and flow of chips across casino tables; high-velocity gambling that makes the churn of dollars through parimutuel machines slow and lotto games glacial in comparison. Another $25.2 billion were not physical dollars at all, but credits and debits in telephone transactions between American sports and racing fans and the operators of illegal books. Most of the residue, though, some $72 billion, was real currency and coins, handled through track and OTB (Off-Track Betting) totalizers, slot machines, lottery agencies, bingo halls and the Las Vegas Night craps game at local churches and synagogues. That wad of cash made gambling a major component of the U.S. leisure economy . . ."

Gambling Dollars, Fiscal Year 1986

	$Billions	% of Total
Total "Handle"	199.0	100.00
Legal gambling	166.5	83.67
Casino table games	101.4	50.95
Slot machines	28.5	14.32
State lotteries	12.5	6.28
Horse racing	12.4	6.23
Bingo	3.6	1.81
Greyhound racing	3.6	1.81
Other	4.5	2.26
Illegal gambling	32.5	16.33
Bookmaking, etc.	27.0	13.57
Numbers games	5.5	2.76



Basic Data: Gaming & Wagering Business

of gambling's influence on the economy and politics — state lotteries now are by far the leading form of commercial gambling and the fastest growing.

Latest sign of lotteries' growth came on November 3 when a state game was approved by Virginia, often considered a bellwether for the Old South. That tier of states, except for non-typical Florida, had been the only regional hold-out against lotteries. Another victory for legalized gambling came in Texas, which approved state-sanctioned horse racing and betting for the first time in modern times. With these cracks in the South's front against gambling, the stage is set for a new phase in the hassles over gambling's role in public finances.

Re-play of history. Today's scene is a replay of 19th Century American history, to some extent. Lotteries to raise money for public purposes were common in colonial times. The early Harvard and Yale universities were financed in part with lottery proceeds. The Continental Congress approved a lottery to finance the American Revolution but it failed; the Tories had most of the money.

By the 1830s a number of states had approved various types of lotteries. They generally were state franchises, privately and loosely administered by "lottery contractors" (who included the forerunners of today's Chase Manhattan Bank and Citicorp) and scandals crept into the system. In the aftermath, most states adopted sweeping anti-gambling laws, often embedded in the constitutions of new states. Lotteries, as state-blessed ventures, disappeared.

The Federal government took the stance that gambling was a societal phenomenon and a state responsibility. Enforcement of state laws and local ordinances prohibiting gambling, however, proved to be sporadic and ineffective.

Illegal betting flourished, more or less openly, virtually everywhere. The illegal "numbers" racket, born in New York City's Harlem in the early '20s, proliferated into most big cities, especially after Prohibition ended in 1933 and bootleggers had to find a new field to exploit.

Gambling's Revival. The breakthrough for a return to legalized gambling came in 1931 when Nevada, desperate for revenue after mining's collapse in the Depression, became the first state to legalize casinos offering roulette and other wagering games, with the state govern-

ment an active partner in supervising operations and sharing in the profits.

Other states in the East and Midwest followed that lead by authorizing similar partnerships in pari-mutuel horse racing (where pools of bettors place their opposing bets, and the track takes a percentage, paying part of that to the state usually in the form of license fees and taxes).

The Federal government got into the action through income taxes on bettors' winnings, plus "occupation" taxes on professional full-time gamblers and slot machines. The latter never produced as much revenue as predicted.

After the troops came home from World War II, wagering grew faster and faster. Illegal gambling became big business, increasingly intertwined with nationwide criminal syndicates and local political corruption. That brought limited Federal intervention in the form of statutes aimed at interstate transmission of gambling information and equipment, mainly useful as leverage against criminals active in drugs, prostitution, "protection" and other mob rackets.

The Lottery Parade. Then, in 1963, the New Hampshire legislature, confronting a state constitutional bar to an income tax, authorized a twice-a-year sweepstakes on horse race results, with the proceeds dedicated to public education. That was the start of the modern fling with state owned and operated lotteries as an integral part of the states' public finances.

New Hampshire's maiden venture was a financial flop at first, and nearly died when neighboring New York began a competing monthly sweepstakes in 1967. The New York operation also failed at first, and was marred by political patronage squabbles which led to its suspension in 1975-76.

But with aggressive marketing and ingenious designs of new games, the early lotteries became financial successes — and politically contagious. In state after state, lottery forces succeeded in getting the issue on statewide election ballots, and usually won by robust margins.

Opponents argued that lotteries are a regressive tax, in effect, bearing hardest on low-income players least able to pay; that lotteries breed gambling fever which creates more compulsive gamblers, fosters a breakdown of public morality and spreads criminal influences in a state's economy and politics. Supporters argued that the public will gamble, one way or another; that voters like lotteries, that participation is voluntary and the money goes for good causes.

Supporters have prevailed, up to now, hitting a peak in 1984 when all four states that had a lottery proposal on the ballot, including California, approved them. North Dakota, however, rejected a lottery in 1986.

Next: Super Jackpots, VDTs. As more states jump into lotteries, competition grows for players and dollars, spurring heightened promotion and marketing drives by lottery agencies, manufacturers of the machines involved, advertising experts, community vendors of tickets.

One major ploy is to increase the size of winnners' prizes as much as possible within the limits imposed by the mandatory level of paybacks to the customers (typically around 50 percent compared with the pari-mutuels' payout rate of around 80 percent), operating costs, and the pressure to meet revenue goals. Lotteries are highly leveraged. After the break-even point, profits are rich. This is leading to multi-state lotteries, which greatly enlarge the pool of players and the potential jackpots for winners.

First was the New England Tri-State game launched in 1985 by Massachusetts, New Hampshire and Vermont. Latest is "Lotto America," announced in Washington September 16. Taking part with the District of Columbia will be

Lotteries as Revenue Raisers
($ in millions)

■ **Lotteries' net is small compared with total state revenues. In fiscal year 1986 —**

States with Lotteries	Lottery Sales	Net Lottery Income After Prizes, Expenses	Net Lottery Income As % of All State Taxes (Property, Income, Sales, etc.)	Net Lottery Income As % of All Own-Source State Revenue†
AZ	121.0	42.3	1.3%	††
CA(1)	1,765.6	692.7	2.2	1.5
CO	111.3	28.4	1.2	††
CT	429.1	190.9	5.0	3.7
DE	40.9	16.7	1.9	1.2
DC	118.7	35.9	2.1	N.A.
IL	1,284.2	540.2	5.5	3.9
IA(2)	81.7	25.9	1.0	††
ME	38.8	11.8	1.0	††
MD	718.3	323.8	6.9	4.8
MA	1,397.9	439.8	5.7	4.8
MI	999.4	415.1	4.4	3.1
MO(3)	81.1	207.0	2.2	4.0
NH	33.8	10.7	2.2	1.0
NJ	900.1	418.2	5.0	3.2
NY	1,317.0	607.9	2.7	1.6
OH	940.0	383.6	4.2	2.6
OR	87.4	26.5	1.4	††
PA	1,320.0	539.2	5.0	3.3
RI	56.9	21.6	2.4	1.3
VT	12.4	3.3	0.1	††
WA	181.2	73.0	1.4	††
WV(4)	53.0	21.0	1.1	††

(1) Lottery began October 1985
(2) Lottery began August 1985
(3) Lottery began January 1986
(4) Results for period of April 1985 (when lottery began) through June 1986
† Excludes Federal grants, "Intergovernmental" transfers
†† Less than 1%

■ **Yet lotteries now bring in more revenue than tobacco and alcohol sales taxes in 10 states and the District of Columbia — a trend closely watched by state finance officers who are worried about the future of tobacco/alcohol sales, and prospective declines in the revenues they generate.**

Iowa, Kansas, Missouri, Oregon, Rhode Island and West Virginia. The jackpots are expected to reach $10 to $20 million. Promoters hoped California and New York would join, and they may yet. That could bring jackpots up to $80 million or more.

As a lottery's size swells, so do the odds against winning, rising to the tens-of-million-to-1 class, and that might turn off the public. So far the lure of larger prizes seems to enlarge the "play" — and profits.

Another coming idea, already being tried in some places, is lottery games played on video display terminals (VDTs). This provides the elements of player participation and instant payoffs; proven inducements to gamble as shown by the popularity of slot machines ("one armed bandits") and pinball machines.

Eventually, as the interstate connections of lotteries and their suppliers increase, there could be moves in Congress to regulate, if not prohibit, the growing lottery industry. A sizable scandal in lotteries' management, involving prominent politicians and frauds on the public, could touch off that kind of reaction.

"Constant tug of war." The most thorough study of gambling in America, legal and illegal, was three years of investigation and hearings by a commission created by Congress in 1970 anti-crime legislation. In its 1976 final report the Commission made these points:

- "Gambling is inevitable. No matter what is said or done by advocates or opponents of gambling in all its forms, it is an activity that is practiced, or tacitly endorsed, by a substantial majority of Americans . . .
- "Because it is a social issue, the Commission has determined that gambling policy is the proper responsibility of the government entity closest to the lives of citizens — the State . . ."
- "Current gambling policy at the State level accurately reflects the ambivalence and contradiction that have traditionally characterized this nation's approach to the problem of gambling. The States often have found it difficult to formulate reasonable and consistent gambling policy and law. Over the years, two strong, conflicting sentiments have surfaced: That gambling is a morally and socially destructive activity that must be suppressed, and that the enormous popularity of gambling makes it a suitable activity for government to channel into useful and productive ends through licensing and taxation. The history of gambling policy in the United States has been a constant tug of war between these two philosophies, in which each side appears to gain the advantage for a certain period and then begins to lose ground . . ."

A FEDERAL NATIONAL LOTTERY ?

Some members of Congress and high-level officials of the Reagan Administration have cast covetous glances at the money flow generated by state-operated lotteries.

The idea keeps cropping up that maybe a national lottery could bring billions of dollars into a Federal treasury that is deeply in the red. In lottery backers' dreams, the profits would be dedicated to deficit reduction or other worthy goals, such as improved education or medical care for the indigent or homeless housing.

The list of possible uses for any Federal lottery income is long; but the list of open supporters is short, as of autumn, 1987.

In Congress, 5 members of the House have introduced 7 bills (Rep. Cardiss Collins of Illinois made 3 proposals) that if enacted would authorize a national lottery of some type. The House Ways & Means Committee had scheduled no hearings on these bills at the time of this report.

At the Treasury Department, Secretary James Baker reportedly has showed some interest in lottery revenue possibilities. But in its only recent public comment, the Treasury replied negatively to a suggestion that the IRS operate a lottery with tax-exempt prizes, for deficit reduction.

At the White House, members of advisory groups such as the Domestic Council talk, at times, of the dollars a successful 50-state lottery might bring in. But it's just talk so far. The states, it is assumed, would rise up in united wrath if "the Feds" tried to move into the lottery money trough.

In short: National politicians apparently feel they have enough problems without dabbling in gambling. A Department of Army trial balloon for a sweepstakes at overseas posts to benefit Army welfare funds was floated in late '86, and shot down as soon as it ascended to higher, and more politically sensitive, heights. By contrast, the Treasury Department stoutly defends its gambling taxation turf, including income-tax withholding on state lottery winners' prizes above $500, for example.

Note: Sources for this report included "Gambling in America," Final Report of the Commission on the Review of the National Policy Toward Gambling (published by Government Printing Office in 1976, now out of print); "The Business of Ris$k" by Abt, Smith and Christiansen (published by University Press of Kansas in 1985); "Implicit Taxation in Lottery Finance" by Clotfelter and Cook, Working Paper 2246 (published by National Bureau of Economic Research Ins., in 1987).

(OECD, *from page 2*)

Japan raised over one-fifth of its 1985 receipts by taxing corporate incomes, ranking highest among the OECD nations. Seven percent of total tax receipts were derived from corporate income taxes in the United States in 1985, close to the OECD average of 8 percent. At the low end, Greece raised just under 3 percent of its revenues by taxing corporate income.

Taxes on goods and services (sales or consumption levies) are second to income taxes as revenue-raisers in OECD countries. They provide an average of 30 percent of tax revenues. Governments in the United States raise just 18 percent of total receipts from such taxes, placing the U.S. 22nd among the 23 OECD members in terms of reliance on consumption taxes. Japan's consumption tax is the lowest of the OECD nations at 14 percent while Ireland gets 45 percent of its total tax revenue by taxing goods and services.

Social security levies follow income and consumption taxes as the third largest revenue source for OECD countries, providing about 24 percent of all tax receipts. Variations from country to country are significant, however. Australia and New Zealand do not levy social security taxes. Denmark gets less than 4 percent of its revenue from such taxes. By contrast, social security taxes accounted for more than 41 percent of total tax revenues in France, Spain, and the Netherlands. The United States ranked in the middle range, 11th among OECD countries, getting 29 percent of its taxes from social security collections. However, social security taxes in the U.S. have increased substantially from 16 percent of total tax revenue in 1965 to 29 percent in 1985.

Property taxes generally are not a major source of tax revenue among OECD nations, providing 5 percent of total taxes on average. In 1985, the United Kingdom ranked first in its reliance on property taxes (12 percent of total), followed by the United States and Japan at 10 percent.

Another way to compare tax systems among the major industrialized countries is to examine the size of their tax receipts in relation to economic production. The OECD measures this by gross domestic product, or GDP.

The ratio of tax revenues to gross domestic product averages 37 percent in the 23 OECD countries. By this measure, Sweden is the "most taxing" nation, with receipts coming to just over 50 percent of GDP in 1985. Denmark ranks second at 49 percent. U.S. taxes in 1985 comes to 29 percent of GDP, placing this country 20th among its OECD affiliates. At the low end were Japan and Turkey at 28 and 16 percent of GDP, respectively.

The table and chart on page 2 provide further details on the distribution of tax revenues in selected countries for fiscal year 1985.

THE FRONT BURNER

By Robert C. Brown
President, Tax Foundation

"The Yankee Trader — An Endangered Species?"

The Yankee Trader used to be the prototype of the enterpreneurial spirit, roaming the seven seas with American made goods in American made vessels manned by American sailors. Indeed, the right to make and sell goods to export markets was one of the issues behind the American revolution.

Well, as the songwriter says, "the times they are a-changin'." The trade deficit is one of the two chief millstones around the neck of the American taxpayer. (The other, of course, is the budget deficit, although it begins to look as if we may finally see some concrete progress toward real deficit reduction by the time this publication is off press.) Our balance of payments is a disaster. Our merchant marine is a shadow of its former self. We are not even capitalizing on our own technological breakthroughs. (We developed the VCR; only Japan makes and sells it.)

What is the solution the U. S. Congress threatens to foist on U.S.–based multinationals? A protectionist trade bill that will only worsen the situation. In the face of a major threat that our status as a world trader is becoming second rate, all Washington can do is close the borders, inviting retaliation by the other players in the game. To call such a step counterproductive is to overstate the obvious.

Where does the real solution lie? On September 18 of this year, the Wall Street Journal published a market valuation ranking of the world's 100 largest public companies. The U.S. could lay claim to 40 of those top slots. Not so bad, you might say, in this age of growing world economic unity. Maybe. Japan, which was literally on its knees just 30 years ago, owned 44 of the top 100. All other nations — Great Britain, West Germany, France, Korea, Taiwan, and any other you care to name — were, as mathematicians say, statistically insignificant.

Why this astounding fall from grace for the Yankee trader? Trade policy is a partial explanation. Another reason is tax policy. The United States does not — as do Japan, West Germany, The Netherlands, and others — encourage multinationals to be aggressive in developing overseas markets. Instead, we tax them so heavily that it is hardly profitable for them to compete. From a tax policy perspective, there are those who would say you were crazy if you started a multinational corporation and based it in the United States. A major improvement would be simply to treat our multinationals the way other major trading nations do.

In the key area of world trade competitiveness, tax policy driven almost exclusively by revenue considerations is causing side effects that are very, very harmful.

Public Finance:
An Information Sourcebook

by Marion B. Marshall
Tax Foundation Research Librarian

Oryx 287 pp 10/87 $45.00

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(FEDERAL SPENDING, *from page 4*)

postwar era, they escalated to more than 10 percent of total spending. Over the past decade, however, their share has shrunk to 6 percent, and they now comprise approximately the same portion of spending as they did in the mid-1960s. As noted in Table 2, the amounts shown for these grants do not include payments for individuals (such as medicaid and aid to families with dependent children) which are passed through state or local governments. These payments now comprise half of all total grants to states and localities.

Defense is another category that has gone through ups and downs. Between 1957 and 1977, defense dropped from almost 60 percent to less than 25 percent of Federal spending. The recent buildup has increased the defense share of the budget, but it still is much lower than it was after World War II.

Discretionary domestic spending — the "all other" category — has been least successful in the competition for Federal dollars. This category accounted for almost half of total spending in 1938; it now gets only about 10 percent. This part of the budget finances the ongoing operations of Federal agencies, including such diverse and well-established activities as the national parks, health research, and space exploration.

Both payments for individuals and interest costs are forms of transfers from the Federal government to outside recipients of public funds. Together, they comprise almost two-thirds of the budget. The growth of these transfers has important implications for the Federal budget.

Budgeting Now More Dependent On Economic Performance

When the Federal government began to use the budget in the postwar period as a key instrument of fiscal policy, transfers were seen as automatic stabilizers that would restrain the economy when it was overheated and stimulate it when it was weak. But the increasing impact of transfers has made their role in budgeting both structural and cyclical. Transfer spending rises when the economy is strong as well as when it is weak. Rather than the budget balancing the economy, the economy can unbalance the budget. In some recent years, more spending has been added to the budget by changing economic conditions than by discretionary policies.

Annual Rise in Spending Mostly Due to Entitlements

Most transfers are mandatory entitlements whose level cannot be determined by budgetary or appropriation decisions alone. Unless the law establishing the entitlement is changed, the government must pay the required amount, regardless of economic conditions or other demands on the budget.

The cost of most entitlements goes up automatically, without any action by the President or Congress. The aging of the population, price changes, and other developments add greatly to annual transfer payments. Largely because of these entitlements, three quarters of the Federal budget is classified by OMB as "relatively uncontrollable under existing law." There is, of course, no inherent reason why Congress cannot control spending better by changing existing law. But it takes a great deal of political muscle to do so.

Budgetary Power Redistributed In Congress

The rise of transfers has shifted spending power from the appropriations committees to authorizing committees. At one time, the appropriations committees had control of virtually all Federal expenditures. Today, however, these committees have jurisdiction over barely one-half of the budget and effective control of only one quarter. While authorizing committees, which have jurisdiction over legislation dealing with transfer programs, have enhanced their budget role, budgeting has become a more turbulent process as the numerous participants in the process vie for power.

The growth of transfers is not likely to be reversed, though it probably will be much slower in the next 50 years than it was in the past 50. The Federal government has had great difficulty adjusting its budget practices to this reality. The political deadlocks and budget deficits of recent years suggest that the necessary adjustments have not been made.

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